

23 October 2024

Dropsuite Limited (DSE)

BUY

Share Price: **A\$3.79**

Growth opex to extend into CY25

Target Price: **A\$3.98**

DSE has delivered another strong quarterly result, with 3Q24 ARR (USD) increasing by 34% on pcp. The result reflects positively on DSE's ongoing intent to reinvest in growth, and was predicated on record net seat adds during the period. While ARPU did fall marginally, this was driven by sales mix changes, with the GP margin stable at 69%. Having made modest (in absolute terms) changes to our growth opex assumptions, we reiterate our Buy rating, with a new TP of \$3.98ps.

A strong 3Q24 update

- DSE has delivered a very strong 3Q24 update, with the key features being (i) an ARR increase of 27% (+34% in USD terms) on pcp to A\$42.6m, and (ii) \$0.8m of Op. CF, which is up sequentially from \$0.6m in 2Q24.
- The strong uplift to ARR was driven primarily by record seat adds of 135k, which brought DSE's total paid user number to 1.48m. This was above our forecast, with the ARR benefit offset by a lower-than-expected ARPU.
- Notwithstanding the lower-than-expected ARPU, DSE's gross profit margin was maintained at 69%. This is in line with our forecast and implies that the lower 3Q24 ARPU is due to sales mix rather than pricing pressure.
- Given the positive ARR response to recent investments in growth opex, it seems probable that this approach will continue in CY25. This will limit near-term margin gains but deliver a more resilient and scalable revenue base.

Mixed earnings forecast revisions

- While our revenue forecasts are largely unchanged, we have lifted our EPS estimate for CY24 by 52% (+\$0.4m net profit) and lowered our CY25 and CY26 estimate by 27% (-\$0.7m net profit) and 14%, respectively.
- Key driver is changes to our growth opex assumptions, which we have (i) increased in size, and (ii) reallocated more evenly to both CY24 and CY25. Previously we had assumed a larger weighting to CY24.

Reiterate Buy and lift TP to \$3.98ps (from \$3.65ps)

- We believe DSE has the products, business model and capital to exceed system growth within its target market. DSE has a strong MSP-led product offering and a large TAM relative to its current revenue base.
- We continue to use an EV/sales ratio to estimate DSE's fair value, with our ascribed NTM ratio of 5.0x based on N-ABLE's current consensus multiple and compares to our overall assigned peer group NTM average of 6.2x.

Key date ahead

- 4Q24 business update (mid-January 2025).

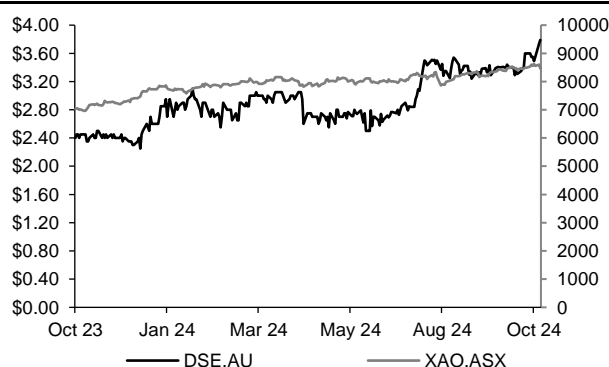
Company Data

Shares – ordinary (M)	70.3
Dilution (M)	0.6
Total (fully diluted) (M)	70.9
Market capitalisation (\$M)	266.3
12-month low/high (\$)	2.2 - 3.74
Average monthly turnover (\$M)	8.0
GICS Industry	Software

Financial Summary (fully diluted/normalised)

Year End	December	2022A	2023A	2024F	2025F	2026F
Revenue (A\$m)		20.7	30.6	40.0	52.8	64.9
Costs (A\$m)		19.4	29.5	39.4	51.4	60.8
EBITDA (A\$m)		1.3	1.1	0.6	1.3	4.1
NPAT (A\$m)		1.5	1.6	1.2	1.8	4.6
EPS (¢)		2.1	2.3	1.7	2.5	6.3
EPS Growth (%)		>100.0	7.8	-24.5	45.6	152.3
PER (x)		182.6	167.6	219.5	150.7	59.7
FCF (A\$m)		0.9	2.1	2.1	2.1	5.2
FCF per share (cps)		1.2	3.0	3.1	3.0	7.2
Price to FCF (x)		311.6	124.4	123.7	126.2	52.7
EV (A\$m)		244.8	242.4	242.1	242.4	240.0
EV/EBITDA		195.7	219.4	390.1	182.2	58.2
Payout ratio (%)		0.0	0.0	0.0	0.0	0.0
Dividend (¢)		0.0	0.0	0.0	0.0	0.0
Net Yield (%)		0.0	0.0	0.0	0.0	0.0
Franking (%)		0.0	0.0	0.0	0.0	0.0

DSE – performance over one year



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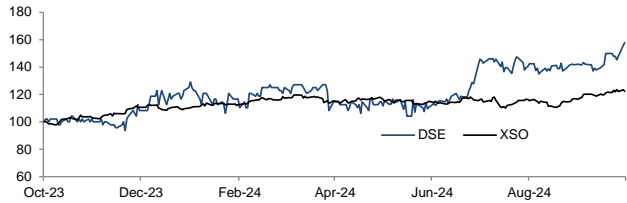
Analysis

Dropsuite Year End December

MARKET DATA

Recommendation		Buy
Price	A\$	3.79
Price target (12-month)	A\$	3.98
52 week high / low	A\$	2.2 - 3.74
Market capitalisation	A\$m	266.3
Shares on issue (basic)	no.	70.3
Performance rights	no.	0.6
Other equity	no.	0.0
Shares on issue (diluted)	no.	70.9

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS

	2022A	2023A	2024F	2025F	2026F
Underlying net profit	\$m 1.5	1.6	1.2	1.8	4.6
Reported net profit	\$m 1.5	1.6	1.2	1.8	4.6
Reported EPS (diluted)	€ 2.1	2.3	1.7	2.5	6.3
Normalised EPS (diluted)	€ 2.1	2.3	1.7	2.5	6.3
...Growth	% >100.0	7.8	(24.5)	45.6	152.3
Normalised diluted PER	x 182.6	167.6	219.5	150.7	59.7
Adjusted Op. CF per share	€ 1.3	3.2	3.5	3.4	7.6
Adjusted FCF per share	€ 1.2	3.0	3.1	3.0	7.2
Price to free cash flow per share	x 311.6	124.4	123.7	126.2	52.7
Free cash flow yield	% 0.3	0.8	0.8	0.8	1.9

PROFIT AND LOSS

	2022A	2023A	2024F	2025F	2026F
Total revenue	\$m 20.7	30.6	40.0	52.8	64.9
EBITDA	\$m 1.3	1.1	0.6	1.3	4.1
Depreciation & amortisation	\$m 0.1	0.2	0.3	0.3	0.3
EBIT	\$m 1.2	0.9	0.3	1.0	3.9
Net interest	\$m (0.3)	(0.7)	(0.9)	(0.8)	(0.7)
Non-operating income	\$m 0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m 1.5	1.6	1.2	1.8	4.6
Tax expense	\$m 0.0	0.0	0.0	0.0	0.0
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
Reported NPAT	\$m 1.5	1.6	1.2	1.8	4.6
Significant items	\$m 0.0	0.0	0.0	0.0	0.0
Underlying NPAT	\$m 1.5	1.6	1.2	1.8	4.6

KEY RATIOS

	2022A	2023A	2024F	2025F	2026F
EBITDA margin	% 6.0	3.6	1.6	2.5	6.3
EBIT margin	% 5.8	2.9	0.8	2.0	5.9
Underlying net profit margin	% 7.0	5.2	3.0	3.4	7.0
Return on average equity	% 15.2	15.9	16.8	16.9	16.7
Return on average assets	% 12.2	13.7	14.4	14.6	14.5
Net tangible assets per share	€ 35.1	39.3	41.1	43.3	49.1
Net debt / (cash)	\$m (22.3)	(24.3)	(26.4)	(28.6)	(33.7)
Interest cover (EBIT / net interest)	x n/a	n/a	n/a	n/a	n/a
Leverage (net debt / EBITDA)	x n/a	n/a	n/a	n/a	n/a
Gearing (net debt / net debt plus equity)	% n/a	n/a	n/a	n/a	n/a

GROWTH PROFILE

	2022A	2023A	2024F	2025F	2026F
Operating revenue	% 76.8	48.1	30.6	31.9	23.1
EBITDA	% >100.0	(11.7)	(43.8)	114.3	209.8
EBIT	% >100.0	(26.2)	(63.4)	221.0	273.4
Operating NPAT	% >100.0	9.2	(23.6)	48.0	154.8
Normalised EPS	% >100.0	7.8	(24.5)	45.6	152.3
DPS	% 0.0	0.0	0.0	0.0	0.0

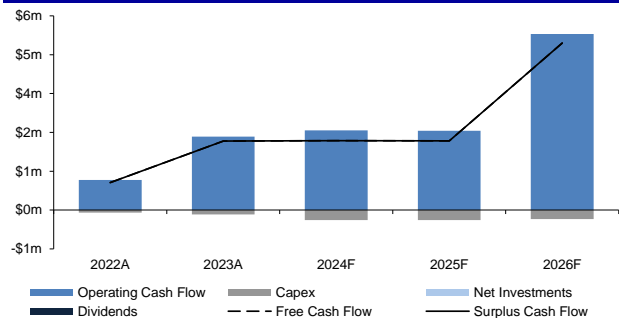
DUPONT ANALYSIS

	2022A	2023A	2024F	2025F	2026F
Net Profit Margin	% 7.7	8.5	9.7	10.6	11.5
Asset Turnover	x 1.4	1.3	1.2	1.1	1.1
Return on Assets	% 11.1	11.4	11.9	12.1	12.1
Financial Leverage	x 1.4	1.4	1.4	1.4	1.4
Return on Equity	% 15.2	15.9	16.8	16.9	16.7

BALANCE SHEET

	2022A	2023A	2024F	2025F	2026F
Cash	\$m 22.3	24.3	26.4	28.6	33.7
Receivables	\$m 4.1	5.9	7.6	10.0	12.3
Inventory	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.4	0.7	0.8	0.8	0.8
Current	\$m 26.8	30.8	34.9	39.4	46.9
Prop, plant & equip	\$m 0.1	0.1	0.2	0.2	0.2
Goodwill	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.1	0.2	0.7	0.9	1.1
Non current	\$m 0.1	0.4	0.9	1.1	1.3
Total assets	\$m 26.9	31.2	35.7	40.5	48.2
Accounts Payable	\$m 2.5	3.2	5.0	6.6	8.1
Borrowings	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.2	0.5	1.6	3.0	4.6
Total liabilities	\$m 2.7	3.8	6.6	9.6	12.7
Net assets	\$m 24.2	27.4	29.1	30.9	35.5
Equity	\$m 24.2	27.4	29.1	30.9	35.5
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
Shareholder's equity	\$m 24.2	27.4	29.1	30.9	35.5
Shares on issue	m 69.0	69.6	70.9	71.5	72.2

CASH FLOW SUMMARY



CASH FLOW

	2022A	2023A	2024F	2025F	2026F
EBITDA	\$m 1.3	1.1	0.6	1.3	4.1
Change in working capital	\$m (1.4)	(1.0)	0.0	(0.8)	(0.8)
Net interest	\$m 0.2	0.7	0.9	0.8	0.7
Tax paid	\$m 0.0	0.0	(0.0)	(0.0)	(0.0)
Other	\$m 0.9	1.5	0.9	1.2	1.4
Operating cash flow	\$m 0.9	2.3	2.5	2.4	5.4
Capital expenditure	\$m (0.1)	(0.1)	(0.3)	(0.3)	(0.3)
Acquisitions/divestment/other	\$m 0.0	0.0	0.0	0.0	0.0
Investing cash flow	\$m (0.1)	(0.1)	(0.3)	(0.3)	(0.3)
Free cash flow	\$m 0.9	2.1	2.1	2.1	5.2
Equity	\$m 0.0	0.0	0.0	0.0	0.0
Increase / (decrease) in borrowings	\$m 0.0	0.0	0.0	0.0	0.0
Dividend/other	\$m 0.0	0.0	0.0	0.0	0.0
Financing cash flow	\$m 0.0	0.0	0.0	0.0	0.0
Net cash flow	\$m 0.9	2.1	2.1	2.1	5.2

Source: Petra Capital

Downward revision to EPS estimates on higher growth opex

As summarised in Figure 1, we increased our CY24 EPS estimate by 52% but lowered our CY25 and CY26 estimate by 27% and 14%, respectively. While our revenue estimates are broadly unchanged, we have modified our opex assumptions to account for (i) higher overall growth opex, and (ii) a more even spread of the growth opex across CY24 and CY25.

Figure 1: Changes to earnings forecasts

Dec Year End	2024F			2025F			2026F		
	Old	New	Δ	Old	New	Δ	Old	New	Δ
Revenue (A\$m)	40.2	40.0	0%	52.6	52.8	0%	64.7	64.9	0%
EBITDA (A\$m)	0.2	0.6	167%	2.1	1.3	-35%	4.9	4.1	-17%
NPAT (A\$m)	0.8	1.2	52%	2.5	1.8	-27%	5.3	4.6	-14%
EPS ¢	1.1	1.7	52%	3.5	2.5	-27%	7.4	6.3	-14%
DPS ¢	0.0	0.0	0%	0.0	0.0	0%	0.0	0.0	0%
FCF (A\$m)	0.8	2.1	173%	1.6	2.1	30%	4.5	5.2	14%

Source: Petra Capital

Updating our target price

In addition to the earnings revisions tabled above, we have also updated our target price methodology to capture our growth expectations for DSE over the next 12 months. This change is summarised in Figure 2, with our target price having increased to \$3.98ps as a result. While we continue to use the consensus EV/revenue multiples for key US peer N-ABLE, other key US peers are also listed.

Figure 2: Updated DSE valuation and target price

Year ending 31 December	CY24	CY25
Revenue	40.0	52.8
EV/revenue	5.46	4.97
N-ABLE	5.46	4.97
SentinelOne ^	9.52	7.54
AvePoint	6.30	5.37
EV	218.5	262.3
Cash	26.4	28.6
Equity value	245.0	290.8
Diluted shares	70.9	70.9
Value per share	3.45	4.10
Weighted average value per share	3.98	

Source: Petra Capital, Bloomberg, ^ Year ending 31 January



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